

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.0 BACKGROUND OF STUDY**

The outbreak of the Asian financial crisis in July 1997 had caused many companies in Asia to struggle for survival. Due to these unfavorable economic conditions, there were many companies facing financial difficulties (Nor Azimah, 2001). Some of the companies had no choice but to file for bankruptcy while some lucky companies opted for restructuring. Restructuring may help companies to continue to run and delay the process of liquidation for the benefit of their creditors (Altman, 1993).

In response to the above mentioned crisis, the governments of the Asian countries took the necessary action to support their corporate citizens by introducing many corporate restructuring options. Some affected Asian governments also established new government bodies to help those ailing companies to restructure themselves. Prior studies have reported that one of the popular options for many Asian companies was the use of the out-of-court restructuring strategy (see Haley, 2000; Mako, 2001). The out-of-court strategy involves negotiations between the respective ailing company, its creditors and other related parties to identify the best solution for the company's financial and debt problems without having to resort to legal proceedings.

In Malaysia, the government also responded to this crisis by introducing many restructuring options including the out-of-court strategy option. For example, the Corporate Debt Restructuring Committee (hereafter termed the CDRC) was initiated in July 1998 as a non-statutory body to facilitate the operation of this strategy. The

main role of the CDRC is to assist those troubled but viable companies in restructuring their debts. Since its establishment, the CDRC has fulfilled its responsibilities successfully. The progress of the CDRC is also very encouraging (see Chotigeat and Lin, 2001; Nor Azimah, 2001). Nevertheless, the effect of the scheme in improving the performances of the companies which had undergone the process has never been tested. We can only assume that those distressed companies were able to reverse their bad financial position and become liquid as soon as they completed the scheme. For this reason, this research attempts to provide some evidence on that matter and study the effect of the debt restructuring scheme on the companies' performances.

### **1.1 RESEARCH OBJECTIVES**

The purpose of this research is to study the effect of the CDRC's debt restructuring scheme on the capital structures and financial performances of the distressed companies. There are two areas to be observed. First, is to examine the changes in the companies' capital structures. Second, is to identify the differences in the companies' financial performances. In addition, this study is also interested in testing the relationship between the capital structures and the financial performances. This is to find evidence as to whether the changes in the companies' capital structures can significantly affect the changes in the companies' financial performances.

### **1.2 SIGNIFICANCE OF THE STUDY**

This study contributes to academia in at least four important areas. Firstly, this study enables us to evaluate the effect of the CDRC's debt restructuring scheme on the capital structures and financial performances of the companies. The result of this

study can provide evidence of whether the implementation of such a scheme is effective or otherwise in improving the companies that faced financial difficulties. This is important as we do not only need to study the factors that caused financial difficulty (Liu, 2000), but we also need to be aware of the effective ways of overcoming the problem.

Secondly, this study allows us to document the types of changes which took place in the capital structures and financial performances of the companies that had implemented the restructuring scheme. This information will enable investors, stock analysts, creditors, shareholders as well as the companies themselves to understand the scheme better.

Thirdly, this study documents evidence on the relationship between the companies' capital structures and the companies' financial performances. This fact contributes to the knowledge of investors, analysts and researchers in analyzing and understanding the capital structures behavior of companies in Malaysia.

Finally, this study also gathers details on the CDRC. Thus, this study can be a useful reference to analysts, academicians and members of the public who are interested in knowing and learning more about the CDRC.

### **1.3 OUTLINE OF THE STUDY**

This study consists of eight chapters. The next chapter, chapter two, reviews prior studies in the areas of financial difficulties, capital structures, leverage, the 1997 Asian financial crisis and corporate restructuring schemes. Chapter three provides a

brief background on the Malaysian business environment as well as the operational part of the CDRC. Then, chapter four discusses the research questions and hypothesis development. Next, chapter five describes the data selection procedures and data compilation, i.e., the sample and data used in this study, while chapter six explains the research method. The empirical results are analyzed in chapter seven. Finally, chapter eight provides a summary and conclusion to the study.